

F I F T H E D I T I O N

# Macroeconomics

STEPHEN L. SLAVIN

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# Macroeconomics

**Stephen L. Slavin**

*Union County College   Cranford, New Jersey*  
*The New School for Social Research   New York City*



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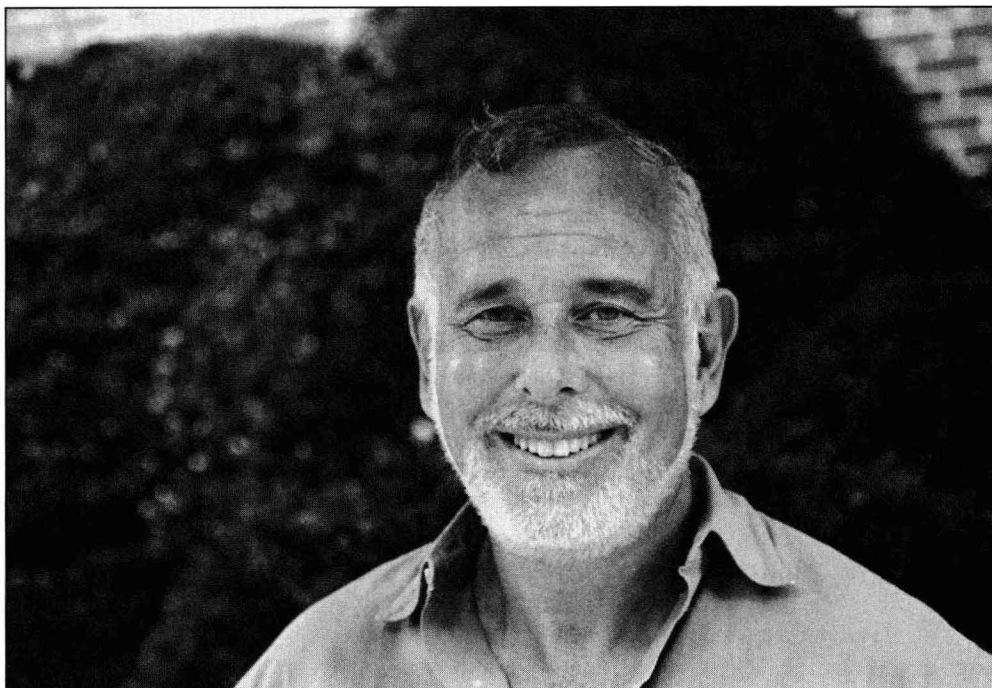
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## ABOUT THE AUTHOR

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Stephen L. Slavin received his B.A. in economics from Brooklyn College and his M.A. and Ph.D. in economics from New York University. He has taught at New York Institute of Technology, Brooklyn College, St. Francis College (Brooklyn), and in the M.B.A. program at Fairleigh Dickinson University, and he now teaches at the New School for Social Research in New York City and at Union County College in Cranford, New Jersey.

He has written eight other books: *The Einstein Syndrome: Corporate Anti-Semitism in America Today* (University Press of America); *Jelly Bean Economics: Reaganomics in the Early 1980s* (Philosophical Library); *Economics: A Self-Teaching Guide*, *All the Math You'll Ever Need*, *Math for Your First- and Second-Grader*, *Quick Business Math: A Self-Teaching Guide* (all four published by John Wiley & Sons); *Chances Are: The Only Statistics Book You'll Ever Need* (University Press of America); and *Everyday Math in 20 Minutes a Day* (LearningExpress). He is the co-author of two other Wiley books, *Practical Algebra* and *Quick Algebra Review*.

Dr. Slavin's articles have appeared in *Studies in Family Planning*, *Economic Planning*, *Journal of BioSocial Science*, *Business and Society Review*, *Bankers Magazine*, *Education for Business*, *Public Management*, *Better Investing*, *Northwest Investment Review*, *U.S.A. Today Magazine*, *Patterns in Prejudice*, *Culturefront*, and *Conservative Review*. In addition, he has written more than 500 newspaper commentaries on public policy, demographic economics, politics, urban economics, international trade, investments, and economic fluctuations.

# PREFACE TO THE INSTRUCTOR



**M**ore than 25 years ago, while still a graduate student, I got a part-time job helping to ghostwrite an introductory text for a major publisher. I asked my editor why so many economics texts were ghostwritten. She smiled and said, “Economists can’t write.”

Economics can be a rather intimidating subject, with its extensive vocabulary, complicated graphs, and quantitative tendencies. Is it possible to write a principles text that lowers the student’s anxiety level without watering down the subject matter? To do this, one would need to be an extremely good writer, have extensive teaching experience, and have solid academic training in economics. In this case, two out of three is just not good enough.

Why did I write this book? Probably my moment of decision arrived about nine years ago when I mentioned to my macro class that Kemp-Roth cut the top personal income tax bracket from 70 percent to 50 percent. Then I asked, “If you were rich, by what percentage were your taxes cut?”

The class sat there in complete silence. Most of the students stared at the blackboard, waiting for me to work out the answer. I told them to work it out themselves. I waited. And I waited. Finally, someone said, “Twenty percent?”

“Close,” I replied, “but no cigar.”

“Fourteen percent?” someone else ventured.

“No, you’re getting colder.”

After waiting another two or three minutes, I saw one student with her hand up. One student knew that the answer was almost 29 percent—one student in a class of 30.

When do they teach students how to do percentage changes? In high school? In junior high or middle school? Surely not in a college economics course.

How much of *your* time do you spend going over simple arithmetic and algebra? How much time do you spend going over simple graphs? Wouldn’t you rather be spending that time discussing economics?

Now you’ll be able to do just that, because all the arithmetic and simple algebra that you normally spend time explaining are covered methodically in this book. All you’ll need to do is tell your students which pages to look at.

The micro chapters offer scores of tables and graphs for the students to plot on their own; the solutions are shown in the book. This will cut down on the amount of time you’ll need to spend putting these problems on the board.

As an economics instructor these last 31 years at such fabled institutions as Brooklyn College, New York Institute of Technology, St. Francis College (Brooklyn), and Union County College, I have used a variety of texts. But each of their authors assumed a mathematical background that the majority of my students did not have. Each also assumed that his graphs and tables were comprehensible to the average student.

The biggest problem we have with just about any book we assign is that many of our students don’t bother to read it before coming to class. Until now, no one has written a principles text in plain English. I can’t promise that every one of your students will do the readings you assign, but at least they won’t be able to complain anymore about not understanding the book.

## Distinctive Qualities

My book has six qualities that no other principles text has.

1. **It reviews math that students haven’t covered since middle school and high school.** (See, e.g., the box, “A Word About Numbers,” Chapter 5, page 82, or “Calculating Percentage Changes,” Chapter 8, page 166.)
2. **It’s an interactive text, encouraging active rather than passive reading.**
3. **It’s a combined textbook and workbook.** Each chapter is followed by workbook pages that include multiple-choice and fill-in questions, as well as numerical problems.
4. **It costs less than virtually every other text on the market.** The fifth edition has the lowest list price on the market for this combined textbook-workbook.
5. **It’s written in plain English without jargon.** See for yourself. Open any page and compare my writing style with that of any other principles author. This book is written to communicate clearly and concisely with the students’ needs in mind.
6. **It is written with empathy for students.** My goal is to get students past their math phobias and fear of graphs by having them do hundreds of problems, step-by-step, literally working their way through the book. Students learn economics best by actively “doing.”

## Current Economic News

The study of economic needs to be conducted within an empirical context. We start, in Chapter 1, with a brief economic history of the United States. In virtually every chapter that follows, we weave current economic news into the discussion. We look at the aftermath of the collapse of the Soviet empire in Chapter 4. In Chapter 11, we talk about the disappearing federal budget deficit, and its implications on fiscal policy.

The Welfare Reform Act of 1996 was the most far-reaching piece of welfare legislation since the New Deal. Its requirements and their possible effects are discussed in Chapter 17. And finally, in Chapter 19, we look at the

Asian financial crisis that has centered in South Korea, Thailand, and Indonesia. After the 1995 Mexican peso crisis and current one in East Asia, one wonders where and when the next crisis will occur.

## Special Features

Three special features of my book are its integrated coverage of the global economy, its extra help boxes, and its advanced work boxes.

### The Global Economy

Until the early 1970s our economy was largely insulated from the rest of the world economy. All of this changed with the oil price shock of 1973, our subsequent growing appetite for fuel-efficient Japanese compact cars, as well as for TVs, VCRs, camcorders, and other consumer electronics made in Asia. As our trade deficits grew, and as foreigners bought up more and more American assets, every American became quite aware of how integrated we had become within the global economy.

Traditionally, principles texts included a couple of chapters at the back of the book on international trade and finance. However, in recent years it has become very apparent to authors that we needed to integrate international material throughout our texts. The fifth edition of my own text follows this practice, and more than ten percent of the book deals specifically with the global economy.

Here are some of the things we look at:

- The “Isms”: Capitalism, Communism, Fascism, and Socialism (Ch. 4, p. 72)
- China: The Premier Communist Power (Ch. 4, p. 75)
- Why the Japanese Savings Rate Has Been So High (Ch. 5, p. 83)
- Foreign Investment in the United States (Ch. 6, p. 117)
- The Cost of Living in the U.S. and Russia: An Alternate Comparison (Ch. 8, p. 172)
- The Effectiveness of Monetary Policy in an Open Economy (Ch. 13, p. 324)
- How the Japanese Drove American T.V. Manufacturers Out of Business (Ch. 18, p. 460)
- The Asian Financial Crisis (Ch. 19, p. 479)
- Will Foreigners Soon Own America? (Ch. 19, p. 484)

### Extra Help Boxes

Students taking the principles course have widely varying backgrounds. Some have no problem doing the math or understanding basic economic concepts. But many others are lost from day one.

I have provided dozens of extra help boxes for the students who need them. They are especially useful to instruc-

tors who don't want to spend hours of class time going over material that they assume should be understood after one reading.

Of course these boxes can be skipped by the better prepared students.

Here are some of the topics covered in the extra help boxes:

- Read only if you still don't understand why  $C$  is 1,000 (Ch. 5, p. 89)
- More on finding autonomous and induced consumption (Ch. 5, p. 94)
- Calculating percentage changes (Ch. 8, p. 166)
- Read only if you're not sure how to calculate the unemployment rate (Ch. 9, p. 192)
- Finding percentage changes in the price level (Ch. 9, p. 199)
- Differentiating between the deficit and the debt (Ch. 11, p. 263)
- Finding the percentage of income share of the quintiles in Figure 1 (Ch. 17, p. 403)

### Advanced Work Boxes

There are some concepts in the principles course that many instructors will want to skip. (Of course, if they're not included in principles texts, this will make some instructors quite unhappy.) These boxes are intended for the better prepared students who are willing to tackle these relatively difficult concepts.

Here is a sampling of my advanced work boxes:

- Post-World War II recessions (Ch. 1, p. 13)
- APCs greater than one (Ch. 5, p. 86)
- Progressive in name vs. progressive in effect (Ch. 7, p. 134)
- Why NNP is better than GDP (Ch. 8, p. 161)
- The accelerator principle (Ch. 9, 187)
- The paradox of thrift (Ch. 11, p. 256)
- Three modifications of the deposit expansion multiplier (Ch. 13, p. 316)
- Rational expectations vs. adaptive expectations (Ch. 14, p. 347)
- The negative income tax (Ch. 17, p. 423)

### Changes in the Fifth Edition

Two basic ways my book is different from all other principles texts is that it is a smoother read and it is interactive. The fifth edition improves on these features.

Most of the really hard stuff is in advanced work boxes and appendices. This relatively difficult material can be skipped, or perhaps assigned for extra credit. The really easy stuff—e.g., math that should have been learned in high

school—is covered in extra help boxes. These boxes save professors hours of valuable class time. For example, students who can't figure out percentage changes can get help from the boxes on pages 166 and 199. In the fifth edition I've added a dozen new boxes. I've also moved the equation of exchange and the quantity theory of money from Chapter 12 (Money and Banking) to Chapter 14 (Twentieth-Century Economic Theory). I wanted to lessen the load of more difficult theory for the student to learn at one time.

Unlike all other principles texts, which encourage passive reading, my book encourages active reading. Students work their way through each chapter, tackling numerical problems, filling in tables, and drawing graphs. Then, at the end of each chapter is a workbook section with multiple-choice and fill-in questions, and problems. In the fifth edition we now have about 100 problem sheets in the Instructor's Manual, which can be torn out, photocopied, and handed out to the students. Let's say a professor assigned the first 10 pages of Chapter 11 (Fiscal Policy and the National Debt). A problem sheet would have a graph and three questions: (1) Is this an inflationary gap or a deflationary gap? (2) How big is it? (3) What two fiscal policy measures would you use to remove it? There's a problem like this in the workbook section of Chapter 11, but this problem comes up at the beginning of a very long chapter. Having these problem sheets saves the professor from having to put this graph on the board and having students spend class time figuring out the answers.

## The Supplement Package

In addition to the workbook, which is built in, *Macroeconomics* has a supplemental package to help students and instructors as they use the text.

## Instructor's Manual

I prepared the instructor's manual to give instructors ideas on how to use the text. The manual includes a description of the textbook's special features, a chapter-by-chapter discussion of material new to the fifth edition, and a rundown of chapter coverage to help instructors decide what they can skip. The answers to the workbook sections of the text are in this manual. New to this edition in the IM are over 30 problem sets designed to supplement almost every chapter.

## Test Bank (Micro and Macro Versions)

I have thoroughly revised the test bank so that it offers more than 3,500 questions. Multiple-choice questions, fill-in questions, and problems are classified by degree of difficulty.

## Teaching Transparencies

The most important graphs and tables from the text are reproduced as two-color transparencies. Use of these acetates

will aid the instructor's classroom presentations and the students' understanding.

## Computerized Testing

The Micro and Macro test banks are available in computerized versions, both for IBM-PC and compatibles and for Macintosh computers. Developed by the Brownstone Research Group, this state of the art software has the capability to create multiple tests, "scramble," and produce high-quality graphs.

## Videos

A selection of videos is available to adopters, including both tutorial lessons and programs that combine historical footage, documentary sequences, interviews, and analysis to illustrate economic theory. There is also a 15-minute video that explains how to get the most out of the book. This may be played during the first day of class.

## Acknowledgments

It is one thing to write an unconventional, even controversial, principles text, and it is quite another to get it published. Gary Nelson, the sponsoring editor at the time my book was signed, saw the project through from its inception to its completion, and I want to thank him for making this book possible. Gary oversaw the development from a bare bones text to a full-fledged principles package.

Paul Shensa, who succeeded Gary Nelson as sponsoring editor, has been a great advocate of my book, both inside and outside the company. I also wish to thank Gary Burke, my publisher, who put together the group that edited and produced the book.

Kezia Pearlman, the developmental editor, saw this project through from the first reviews, the chapter-by-chapter revisions, the test bank revisions, and the dozens of deadlines that we met, to the time the book finally went to press.

Project manager Rob Preskill, with whom I worked day to day, managed the copyediting, artwork, and page proofs, and saw to it that we stayed not just on schedule, but ahead of schedule.

Peter de Lissovoy, the copyeditor with the light touch, suggested hundreds of improvements, large and small, while smoothing out the rough edges of the manuscript.

Francis Owens oversaw the design of the book from cover to cover. Supplements coordinators Louis Swaim and Florence Fong made sure the supplement production process went smoothly.

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Finally, to all adopters of the past four editions, thank you. Your comments and concerns have helped me to write the 1999 edition of *Macroeconomics*.

**Stephen L. Slavin**

# PREFACE TO THE STUDENT

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**W**hat have you heard about economics? That it's dull, it's hard, it's full of undecipherable equations and incomprehensible graphs? If you were to read virtually any of the introductory economics textbooks, that's exactly what you would find.

How is this book different from all other books? For starters, this is the first economics book that is reader friendly. While you're reading, I'll be right there with you, illustrating various points with anecdotes and asking you to work out numerical problems as we go along.

Are you a little shaky about the math? Your worries are over. If you can add, subtract, multiply, and divide (I'll even let you use a calculator), you can do the math in this book.

How do you feel about graphs? Do you think they look like those ultramodernistic paintings that even the artists can't explain? You can relax. No graph in this book has more than four lines, and by the time you're through, you'll be drawing your *own* graphs.

In nearly every chapter you'll find one or two boxes labeled "Extra Help." Sometimes you can master a concept when additional examples are given. Don't be too proud to seek extra help when you need it. And when you don't need it, you may skip the boxes.

Unlike virtually every other economics text, this one includes a built-in workbook. Even if your professor does not assign the questions at the end of each chapter, I urge you to answer them because they provide an excellent review.

I can't guarantee an A in this course, but whether you are taking it to fulfill a college requirement or planning to be an economics major, you will find that economics is neither dull nor all that hard.

**Stephen L. Slavin**

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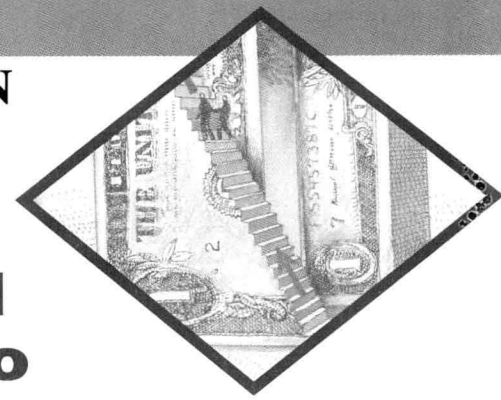
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# INTRODUCTION



## What Is Economics All About, How Do We Use This Book, and Why Is This Book Different from All Other Introductory Economics Textbooks?

*An economist is a man who states the obvious in terms of the incomprehensible.*

—Alfred A. Knopf

**Y**ou've just started reading what may be the shortest introduction with the longest title ever to appear in an introductory economics textbook. Why is this introduction so short? Mainly because I believe in economizing. What is economizing? Funny you should ask.

Economics deals with efficiency—getting rid of waste. That's why this introduction is so short. In fact, that's why this entire book—a textbook and a workbook combined—is so short. We've eliminated most of the extraneous material, the stuff that almost no one reads and virtually no one can understand. What you'll be getting here is 99.44 percent pure introductory economics. If this book were sold in supermarkets, you'd find it with the rest of the no-frills products.

What is economics? Basically, economics is a set of tools that enables us to use our resources efficiently. The end result is the highest possible standard of living.

Economics operates on two levels, the macro level and the micro level. *Macroeconomics* deals with huge aggregates like national output, employment, the money supply, bank deposits, and government spending; and how we can deal with inflation and recession. The first half of the book *Economics* (through Chapter 16) is devoted to macroeconomics.

*Microeconomics* operates on the level of the individual business firm, as well as that of the individual consumer. How does a firm maximize its profits, and how do consumers maximize their satisfaction? These are the types of questions answered by microeconomic analysis, which begins with Chapter 17 of *Economics* (or Chapter 5 of *Microeconomics*).

This book differs from every other introductory text in several ways. Not only is it shorter, but it is much more readable. To modify an old computer term, it is reader-friendly. There are plenty of jokes and anecdotes to illustrate points. And you will be able to do the math even if you are mathphobic.

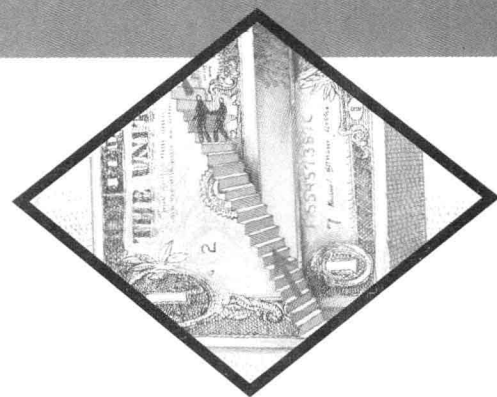
The format of the book encourages you to read actively rather than passively. You will be asked to answer questions and do calculations. Then you'll check your work against my answers.

Before you are asked to do any calculations (and we rarely go beyond eighth-grade arithmetic), there will be a section that reviews the math. For example, just before we explore the subject of consumption (Chapter 5 of *Economics and Macroeconomics*), which is expressed in trillions of dollars, there is a section showing you how to deal with large numbers. If you happen to be one of those people who doesn't know billions from trillions, then this section is for you. But if you do know your billions and trillions, you can pass this section, go directly into the chapter, collect \$200, and roll the dice again.

Actually, I won't claim that reading this book will be quite as much fun as playing Monopoly, or that you will get to collect \$200 whenever you skip a section. But you do get to save some money.

This text gives you two books in one: the conventional textbook and the workbook. Go into any college bookstore and check out the prices. Almost every standard textbook/workbook package will cost you over \$60, so you're already economizing. And yet, in the words of the Carpenters' golden oldie, "We've only just begun."

# A Brief Economic History of the United States



*It was the best of times, it was the worst of times, it was the age of wisdom, it was the age of foolishness, it was the epoch of belief, it was the epoch of incredulity, it was the season of Light, it was the season of Darkness, it was the spring of hope, it was the winter of despair.<sup>1</sup>*

## Introduction

These are the opening words of *A Tale of Two Cities*, which Charles Dickens wrote about 140 years ago. He was writing about Paris and London at the time of the French Revolution, but his words could also describe America today.

Our economy is a study in contrasts. We have poverty in the midst of plenty; we have rapidly expanding industries like computer software and medical technology, and we have dying industries like shipbuilding and consumer electronics; we have won the cold war against communism, but we may be losing the trade war against Japan and China.

Which country has the largest economy in the world, the United States or Japan? Believe it or not, our national output is nearly double that of Japan. Then again, there are twice as many Americans as there are Japanese. But Japan has been gaining on us so quickly that the Japanese may overtake us within a couple of generations.

America is the sole superpower and has one of the highest standards of living in the world. Communism, to borrow a phrase from Karl Marx, has been “swept into the dustbin of history”—at least, the version that dominated the former Soviet Union after the 1920s and Eastern Europe after World War II is no more.

But there are many discordant notes sounding in the United States, ranging from rampant crime and drug use to a permanent underclass to large foreign trade deficits to a standard of living that has not improved much since the early 1970s. Perhaps most alarming, for the first time in our history, the generation that came of age in the 1980s and early 1990s has not done as well as their parents did when *they* came of age.

The baby-boom generation has earned higher incomes than any other generation in history. Indeed, Americans once considered it their birthright to do better than their parents. But that ended some 25 years ago, and a lot of young people are worrying about their futures.

Since the end of the 1990–91 recession, our economy has generated nearly 15 million new jobs. That’s the good news. The bad news is that half of them pay less than \$12,000 per year. These so-called McJobs are often low-level, minimum wage, dead-end positions with no health benefits.

The children of the first baby boomers are now entering the job market. And their parents, after paying \$25,000 or more a year to educate them, are wondering about their children’s job prospects. In the early 1990s job placement counselors were saying that the job market for college graduates was the worst in recent memory. After four years of decline, hiring of college graduates finally rose in 1994 by about 2 percent over the

*The generation that just came of age did not do as well as their parents did.*

*The job market for college graduates is the worst it’s been in recent memory.*

<sup>1</sup>Charles Dickens, *A Tale of Two Cities* (New York: MacMillan, 1955), p. 3. Original work published 1859.